

## Custodial Credit Risk for Governments

Presented By:  
Tom Brege & Jennifer Kielczewski

*Your Vision.  
Our Experience.  
One Powerful Partnership.*

**5/3 Securities, Inc. Institutional Investment Group**

## Background & Contact Information

### Jennifer Kielczewski, A. Vice President, Fifth Third Securities

- Licensed as an NASD Registered Representative (Series 7) as well as a NASD Uniform Securities for State Law Agent (Series 63)
- 6 years of investment experience, specifically in West Michigan for 5 years
- Specializes in building fixed income portfolio's for Michigan Public Funds
- Over \$700 million in assets under management
  - [Jennifer.Kielczewski@53.com](mailto:Jennifer.Kielczewski@53.com)
  - 616-653-5008

### Tom Brege, Vice President, Fifth Third Bank

- Certified Treasury Professional (CTP)
- Over 8 years of Corporate Treasury experience
- Historical focus on Public Funds, Middle Market and Healthcare
  - [Thomas.Brege@53.com](mailto:Thomas.Brege@53.com)
  - 616-653-5792



## What is Custodial Credit Risk?

**Deposit Risks:** The risk that, in the event of the failure of a depository financial institution, the entity will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. Deposits are exposed to custodial credit risk if they are not covered by depository insurance and are:

- Uncollateralized
- Collateralized with securities held by pledging financial institution
- Collateralized with securities held by the pledging financial institution's trust department or agent but not in the entity's name



## What is Custodial Credit Risk?

**Investment Risks:** The risk that, in the event of the failure of a the counterparty, the entity will not be able to recover the value of its investments or collateral securities that are in the possession of the outside party. Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the entity's name and are held by either:

- The counterparty
- The counterparty's trust department or agent but not in the entity's name



## How do I protect myself against Custodial Credit Risk?

### Deposit Accounts:

- Structure deposit accounts to ensure FDIC insurance coverage (multiple accounts at multiple institutions)
- Utilize collateralized sweep account for excess balances (Repurchase Agreement Sweep).
- U.S. Government Agency Money Market Fund – Brokerage product that is 100% Collateralized by U.S Government Agencies (i.e. Fannie Mae, Freddie Mac)

## How do I protect myself against Custodial Credit Risk?

Investment Accounts: GASB is on record recommending Governmental units utilize **third-party safekeeping**.

Third-party safekeeping is an arrangement between the safekeeping institution and the Investment Representative on behalf of the government entity in which all investments are held by the third-party in account identified by the entity's Tax ID and not comingled with any other accounts.

Fifth Third Securities partners with National Financial Services (NFS), an arm of Fidelity to provide **free** third-party safekeeping for all of our customers.

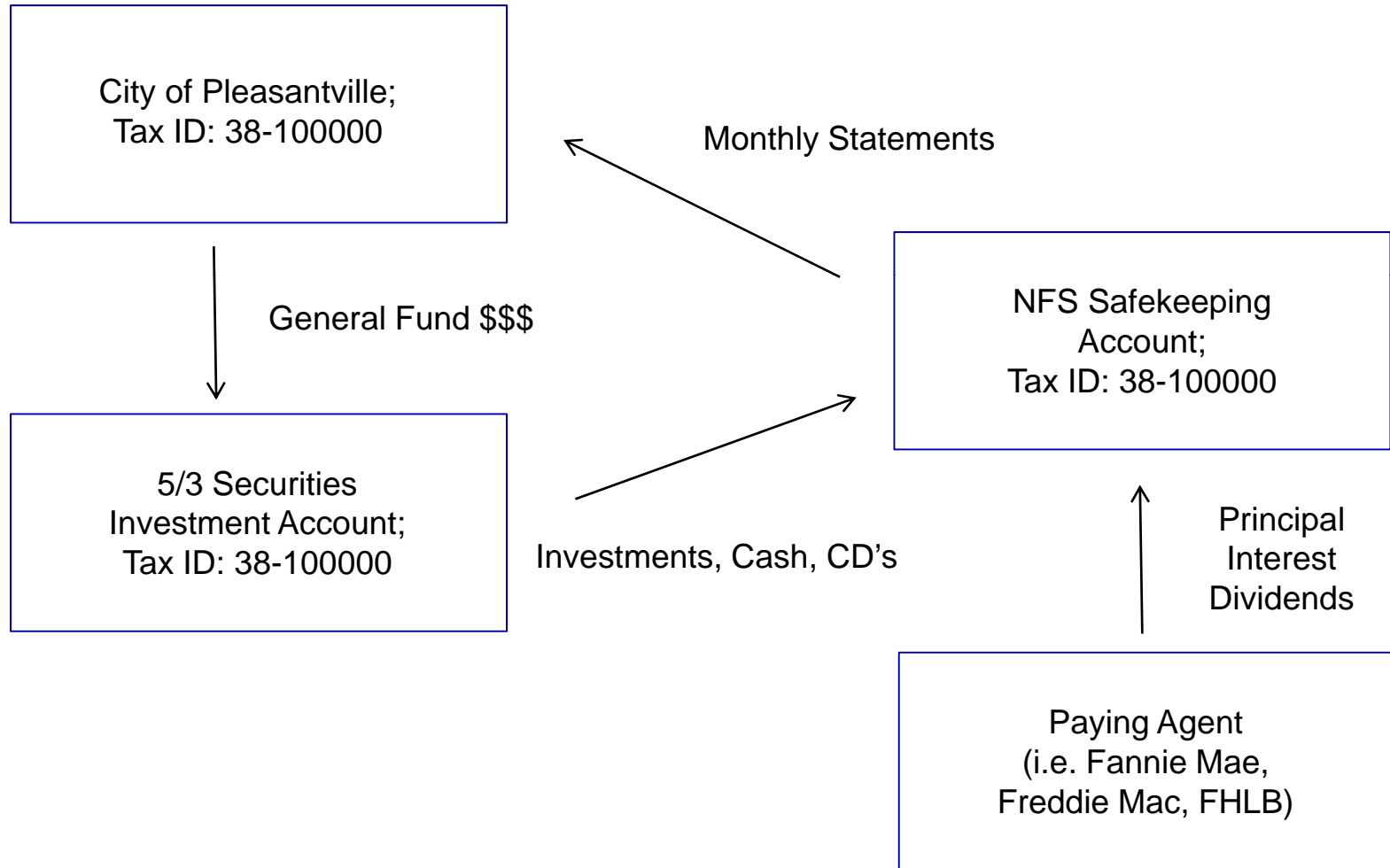
NFS maintains the safekeeping account and distributes monthly statements to each customer on behalf of Fifth Third Securities

Insurance for Investment Accounts: SIPC Insurance and CAPCO Insurance

- SIPC – Securities Investor Protection Corporation; \$500,000 per investment account to protect against fraud
- CAPCO – Customer Asset Protection Company; \$99,000,000 per investment account to protect against fraud. 5/3 Securities participates through NFS

# How do I protect myself against Custodial Credit Risk?

City of Pleasantville; Tax ID: 38-100000





## Are My Fiduciary and Custody Assets Safe?

Assets held in **fiduciary accounts** do not become assets of the bank and are indeed, segregated from the bank's assets. The bank acts as trustee or fiduciary to the account and, in this connection, provides investment management, investment advice and other services to the account. Account ownership remains vested in the individual's or entities for whose benefit the bank is acting as trustee or fiduciary and the assets are not subject to claims of creditors.

- Fifth Third Securities maintains a fiduciary relationship with all customers

Since assets held in **custodial accounts** *do not* become assets of the bank (title is held by the account's owner(s)), it follows that none of this property is subject to the claims of the bank's creditors. As a result, a failure of a bank will have no adverse effect on fiduciary or custodial accounts: they remain the property of the account's owner(s).





## Recent Developments in FDIC Insurance

- October 3, 2008
  - President Bush signed the Emergency Economic Stabilization Act of 2008
  - Temporarily raises the standard maximum deposit insurance amount (SMDIA) on federal deposit insurance coverage from \$100,000 to \$250,000 per depositor
  - Basic deposit insurance limit will return to \$100,000 after December 31, 2009 (see May 20, 2009)
- October 14, 2008
  - FDIC announced its Temporary Liquidity Guarantee Program (TLGP)
  - “Transaction Account Guarantee Program (TAG)” – The FDIC will provide full deposit insurance coverage for all accounts that do not earn interest, low interest NOW accounts ( $\leq 0.50\%$ ), Official Items, and IOLTA accounts. Remained in effect through December 31, 2009.



## Recent Developments in FDIC Insurance

- May 20, 2009
  - President Obama signs the Helping Families Save Their Homes Act of 2009
  - Extends the temporary standard maximum deposit insurance amount (SMDIA) of federal deposit insurance coverage of \$250,000 per depositor
  - Basic deposit insurance limit will return to \$100,000 after December 31, 2013
- August 26, 2009
  - FDIC announces an extension of the TAGP portion of the Temporary Liquidity Guarantee Program (TLGP)
    - The FDIC will continue to provide full deposit insurance coverage for all accounts that do not earn interest, low-interest NOW accounts ( $\leq$  0.50%), Official Items, and IOLTA accounts
    - Remains in effect through June 30, 2010



## Recent Developments in FDIC Insurance

- July 21, 2010
  - The Dodd-Frank Wall Street Reform and Consumer Protection Act signed by President Barack Obama, made permanent the current standard maximum deposit insurance amount (SMDIA) of \$250,000. The FDIC coverage limit applies per depositor, per insured depository institution, for each account ownership category.
- September 27, 2010
  - The Federal Deposit Insurance Corporation (FDIC) Board of Directors approved the issuance of a proposed rule to implement provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act to provide depositors at all FDIC-insured institutions unlimited deposit insurance coverage on noninterest-bearing transaction accounts beginning December 31, 2010 through December 31, 2012.



## Insurance, Collateralization and Gov't Guarantees

### Fixed Income Investments; US Government Agency Bonds

Government Agency: permanent or semi-permanent organization in the government that is responsible for the oversight and administration of specific functions

- Commonly known agencies: Federal Aviation Administration (FAA), US Securities and Exchange Commission (SEC), Federal Deposit Insurance Corporation (FDIC)

Federal Deposit Insurance Corporation: US Government Corporation created in 1933 to provide deposit insurance, which guarantees the safety of deposits in its member banks. Insured deposits are backed by the full faith and credit of the United States.

- Currently \$250,000 per depositor per bank
- 100% insurance for non-interest bearing checking accounts



## Insurance, Collateralization and Gov't Guarantees

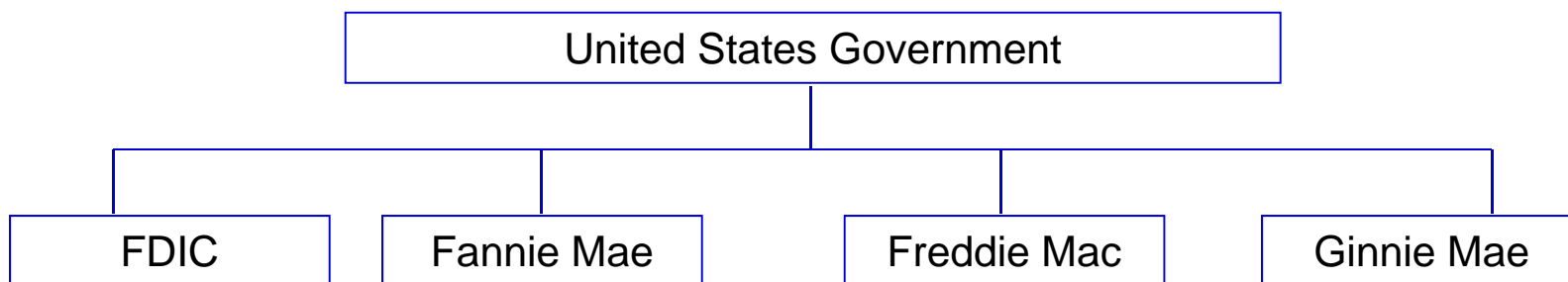
### Fixed Income Investments; US Government Agency Bonds

US Government Agency Bonds: securities issued by government agencies such as Ginnie Mae, Freddie Mac, Fannie Mae, Federal Home Loan Bank and Federal Farm Credit Bank

- As of September 2008, the US Treasury will protect debt and mortgage backed securities issued or guaranteed both *before and after* December 31, 2009\*.

\* Frequently Asked Questions, Treasury Senior Preferred Stock Purchase Agreement, September 11, 2008 [www.ustreas.gov/press/releases/hp1131.htm](http://www.ustreas.gov/press/releases/hp1131.htm)

## Insurance, Collateralization and Gov't Guarantees



- \$250,000 per deposit account
- 100% insured for non-interest bearing accounts

- Bonds are direct purchases from each agency
  - 100% guaranteed by US Government
- Michigan Public Act 20 compliant (most common security utilized by public funds)
  - AAA rated investments
  - \$500,000 of SIPC insurance for fraud
  - \$99,000,000 of CAPCO insurance for fraud

# Custodial Credit Risk for Governments

Accounting and Auditing Implications  
(GASBs 40 & 53)

Presented by:  
Stephen W. Blann, CPA, CGFM

# GASB Statement 40

## Deposits and Investment Risk Disclosures

- Effective June 30, 2005
- Amends GASB 3 and 28
- Requires certain disclosures intended to inform financial statement users about deposit and investment risks that could affect a government's ability to provide services and meet its obligations as they become due



# GASB Statement 40

## Deposits and Investment Risk Disclosures

- Disclosures for specific risks:
  - Custodial credit risk
    - Deposits: uninsured, uncollateralized
    - Investments: uninsured, not registered in the government's name, held by a counterparty
  - Concentration of credit risk
    - Investments in any one issuer >5% of total
    - Excludes investments issued or explicitly guaranteed by the U.S. government and mutual funds

# GASB Statement 40

## Deposits and Investment Risk Disclosures

- Disclosures for specific risks:
  - Interest rate risk
    - Potential loss in value due to fluctuating interest rates
  - Foreign currency risk
    - Potential loss in value due to fluctuation in foreign currency
  - Disclose state law (legal authority) and local policy for each type of risk

# GASB Statement 53

Accounting and Financial Reporting for Derivative Instruments

- Effective June 30, 2010
- Addresses recognition, measurement, and disclosure of information regarding derivative instruments
- Covered in GATS Level 3

# Questions and Answers...

